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C O N F I D E N T I A L SECTION 01 OF 02 AMMAN 007951

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TAGS: EFIN ECON JO KU
SUBJECT: JORDAN'S ECONOMY: TOP OFFICIALS CONCERNED ABOUT INFLATION, DEBT, AND OIL PRICES

Classified By: CDA DAVID HALE, REASON: 1.4 (B, D & E)

¶1. (C) SUMMARY: Jordan's Finance Ministry and the Central Bank of Jordan (CBJ) are increasingly concerned that high levels of liquidity and increasing prices will fuel inflation over the coming year. The CBJ recently raised interest rates by half a percentage point, double the size of increases made over the past year. Should inflation continue to threaten, further interest rate hikes would slow economic growth and could provoke a recession. High fuel prices are still hurting the government's budget, despite a recent reduction in fuel subsidies. Hopes are fading that the government will meet its legally-mandated 2007 debt reduction targets. On the bright side, Kuwait recently rescheduled $220 million in Jordanian debt. END SUMMARY.

INFLATION FEARS

¶2. (C) In recent meetings with Ecouns, CBJ Deputy Governor Faris Sharaf signaled that the Central Bank would change its interest rate policy. Previously, the CBJ had followed the lead of the U.S. Federal Reserve Bank, raising interest rates by a series of quarter-point hikes. Beginning September 21, the CBJ would raise rates by a half-point, regardless of the Fed's move (which was another quarter-point rise). Sharaf said the CBJ is increasingly concerned about the excess liquidity in Jordan, consisting of both domestic funds but also of large capital flows from the Gulf and other neighboring countries. In addition, the GoJ's need to reduce fuel subsidies would also feed increases in prices throughout the economy. Sharaf said he was frustrated that, despite Jordan's booming economy over the past two years (averaging over 7% real growth), the government itself remained "broke." He predicted that, at best, rising interest rates would bring down the real growth rate by several points; at worst, they could provoke a recession. In a separate meeting with Ecouns, Finance Ministry Secretary General Khasasbeh echoed Sharaf's views on inflation, adding that the GoJ expects an inflation rate of 5-6% in 2006, up substantially from this year's 3.4%.

THE DEFICIT, AND PLANNING NEXT YEAR'S BUDGET

¶3. (C) According to CBJ Deputy Governor Sharaf, the recent reduction in the oil subsidy - the third cut in the past year and a half (see Amman 7561) - will bring in an additional JD 40 million (USD 56 million) in revenue. Due to the shift of some of those funds to the social safety net, however, the budget will net only an additional JD 28 million (USD 39 million). Sharaf noted that the IMF had recently agreed with the GoJ's plan to cut the subsidies, and that it shared concerns about increasing inflation in Jordan in 2006. Barring another sharp rise in oil prices, Khasasbeh did not expect another subsidy reduction would be needed before 2006.

¶4. (C) Khasasbeh expected the deficit for the year to reach 5.2% of GDP, up from the 3.3% projected at the beginning of the year. This would yield a deficit figure of USD 570-600 million, based on a projected GDP of USD 11 to 11.5 billion. This would be an improvement on the JD 304 million deficit (USD 426 million) estimated by the Finance Ministry for the first half 2005 alone. (NOTE: septel will report the Central Bank Governor's statement that the current deficit stands at JD 500 million (USD 700 million) and may be substantially lower by year-end, thanks to higher tax revenues. END NOTE.) Some Jordanian officials are still hoping aid from the Gulf will come to the government's rescue, but these hopes are flagging.

¶5. (C) According to Khasasbeh, the GoJ is hard at work on the 2006 budget. In making its calculations, the government will only "book" foreign grants that are "guaranteed," i.e., those from the U.S. and other countries with a regular assistance program to Jordan. This amount will total only JD 220 million (USD 308 million), mostly from the U.S. The projected oil price in the 2006 budget will also be raised to $60/barrel, up from $42/barrel at the beginning of this year for the 2005 budget. When asked whether Jordan would meet

its debt targets under the Debt Management Law, Khasasbeh said he doubted it was possible "without (new) grants."

¶6. (C) Khasasbeh expects real growth to slow to 5.5-6.0% in ¶2006. The current draft budget proposes no cuts in capital expenditures, and JD 150 million (USD 210 million) will be set aside for implementation of the National Agenda which should be released in mid- to late-October. The budget will also include an increase on the value added tax on certain commodities from 4% to 16%, the current level for most products and services. Khasasbeh explained that the IMF had requested this be done on all commodities whose prices are controlled by the government, but the GoJ is proposing to do this for only a third of those commodities. In addition, the government plans to draw down slowly its over USD 5 billion in foreign reserves to finance imports.

DEBT RELIEF FROM KUWAIT

¶7. (C) On the positive side, Khasasbeh confirmed a press report that Kuwait's Fund for Arab Economic Development would reschedule Jordan's USD 220 million debt over a 30-year period and would reduce the interest on the loan to 1%.
HALE